Testimony of

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U.S. PIRG is the federation of state Public Interest Research Groups-- non-partisan, non-profit public interest advocacy organizations based in 30 states. We work with students on more than 100 college campuses across the country. For more than a decade, our Higher Education Project has represented hundreds of thousands of college student members at the federal level by working to increase access to an affordable college education. On behalf of our members I want to thank you for convening this hearing and offering us the opportunity to testify about the growing issue of private student loans.

The issue of providing credit to young people seeking a college education has a long Congressional history. Since the 1950's Congress has identified student borrowers as deserving federal financial support and assistance. Young people, who generally have little or no credit history and no equity, receive unfavorable treatment in the traditional credit market. The subsidized loan programs were created to provide capital to students regardless of their income and credit.

Congress has historically treated student loans differently than other types of debt because their purpose is socially valuable. Students who take out loans are investing not only in their own future, but also in our country's economic, political and social health. Today's hearing, to discuss ways to protect students from predatory private loan terms and interest rates, is consistent with Congress's five-decade interest in helping students borrow for college.

For much of the last 50 years relatively low tuition and federal grant aid meant that federal student loans provided sufficient loan capital to help students finance their education. During this time period, mainly graduate students, pursuing professional degrees, utilized private student loans set at market rates without a federal guarantee. However, in the last decade, and particularly in the last five years, undergraduate students have increasingly utilized unsubsidized private loans to pay for college. The reason is that over the past decade as states have cut funding for public higher education and more of the cost of college has been pushed onto students, undergraduate debt levels have significantly increased. The average college graduate leaves school with approximately $19,000 in debt, but averages only tell part of the story. 7% of students now graduate with an excess off $40,000 in debt, approximately 80,000 a year. That represented a 10-fold increase between 1993 and 2004.[i] Federal loan limits cap undergraduate borrowing by dependent students at $23,000. For some students, this is not enough to cover their full college costs, so they turn to private loans for additional financing.

Private loans are utilized by a subset of undergraduates. About 5% of undergraduate students took out a private loan during the 2003 school year. At non-profit private institutions the percentage was twice as high, about 11.5%.[ii] However, because private loans are on average significantly larger than federal loans, private student debt represents about 20% of overall loan volume borrowed in 2006.[iii] Private loan borrowing has increased at about 27% annually over the past five years, a fact that has caused the issue to gain significant media attention.

Interest rates on private education loans vary based on the student's (or parent's) credit and equity. Students with little or no equity typically rely on a cosigner, usually their parent or guardian. Although information about how particular lenders calculate interest rates is proprietary, loans range from the prime rate to as high as prime plus 12%

in some cases. At current market rates those terms would result in loans at between 8 and 20% interest. Terms on private loans vary widely and do not have to include even the minimally protective repayment options that are required for federal student loans. For example, only some lenders offer deferment options on private loans, which allow student to postpone payments for a time, while interest continues to accrue and compound. In general, private student loans are a costly option for all borrowers and especially costly for low-income students, the very population our federal aid programs are designed to help.

There are a number of reasons to be concerned by the growth of private student borrowing and several critical policy reforms that this Congress should enact to safeguard borrowers. The first problem is that private loans, which can carry such high interest rates, greatly increase the debt burden that many students already struggle with. Take the hypothetical situation of a student who borrows $40,000, half from the Stafford loan program at the fixed interest rate of 6.8%, and half through a private loan with an average interest rate of 12% over the life of the loan. If the student repaid both loans over 10 years, his or her annual loan payments would be $6,000. The interest cost alone in that 10 years would be $21,000, two-thirds of which would be on their private loan. For a student earning $30,000 straight out of college, trying to cover even basic costs like housing, food and transportation this would be an unmanageable loan burden. A college degree means on average greater wealth for the graduate over their career, but not all borrowers will experience that wealth right out of school. Moreover, some students will choose paths that are less profitable, such as teaching or social work, and be faced with an untenable financial situation.

Private student loans work exactly counter to how Congress designed our federal student aid system. The grant and loan programs were created to help, in particular, low-income students who were trying to use higher education to gain access to the middle class. First generation students who were paying their own way through college are the inspiration for our Pell Grant and Stafford Loan programs. Over the past 20 years we have done these students a disservice by shifting federal aid from a majority grant system to a majority loan system. A system with so much unmet need that low- and moderate-income are turning to private loans, where those with the least resources are given the highest interest rates, is a particularly cruel abandonment of Congress's original higher education principles.

The recent sub-prime home mortgage scandal provides another warning about our reliance on private loans. The student lending industry has increasingly marketed private loans to students at sub-prime terms. High interest rate, high-risk loans have enabled banks to expand this already profitable business by lending to less credit-worthy borrowers. As we have seen in the mortgage market, many of these borrowers were unable to repay the loans, devastating thousands of families and sending shock through our economy. Because the growth in private student loans has been so rapid we have yet to see whether the industry suffers the same problems as the sub-prime mortgage market. However, should private student loans suffer the same sort of failure as mortgages, as students graduate or drop out and find themselves unable to pay, we will do serious damage to the lives of many students but also the economic and social fabric of our country that depends on college graduates for its strength.

The final problem in the private student loan industry, and one that this Committee has clear jurisdiction over, is the lack of clear consumer information. Recent studies have found that of private loan borrowers who were eligible for Stafford loans, nearly 20% of dependent students and nearly half of independent students failed to take the maximum Stafford award.[iv] That means a significant number of borrowers took private loans when they had additional capacity to borrow more affordable federal loans. This reporting was consistent with a problem identified in a 2003 U.S. PIRG report looking at college graduates from 2000.[v] At best this trend suggests confusion on the part of borrowers; at worst, it is a symptom of misinformation and manipulation by lenders advertising their private loan products.

Those students who fully understand their options and still decide to take a private loan have no means to compare loan terms between offers. Lenders do not disclose how they calculate private loan interest rates, so that consumers frequently have little more than advertising copy and an “as low as” offer to base their decision on. Adding a further layer of complexity is that there is no standard APR in student loans, leaving even the most educated consumers to try and piece together the impact of various benefits and incentives offered by different lenders.

Lenders further confuse consumers by deliberately masking their products through practices such as “co-branding.” In such a situation the school agrees to lend the institution’s name, colors and brand to the bank’s loan product. Students, having survived the FAFSA process are thus expected to discern that a “State University Loan” is actually a risky private loan wrapped in the colors of their future college. The financial aid process should be transparent and clear, designed to help students access a college education. By contrast the growing private loan market places pitfalls in their path. We would encourage Congress to help fix this system with the following recommendations:

Recommendations

Over the past several years the private loan system has expanded beyond the scope of current regulation. What is clear in the wake of recent student loan scandals, the sub-prime mortgage crisis, and high levels of public concern about college affordability is that Congress must act to help students.

Provide students with clear information on the cost of private loans: Mandate that all private loans have an APR, provided to students before they sign their promissory note; also a cooling-off period, comparable to federal student loans, where they can return their loan at no cost.

Distinguish between private student loans and federal student loans: Mandate that schools distinguish clearly between federal student loans and private student loans in financial aid offers; ban “co-branding” of loans where banks use the logo and name of the school to make their financial product seem more appealing.

Treat student borrowers more fairly in bankruptcy: Student loans, both private and federal, are currently treated more harshly than almost all other forms of debt in bankruptcy. People who borrow to pay for college, and are subject to the high costs and harsh terms of private student loans, deserve fair treatment, especially given the societal value of higher education.

Provide students with anti-fraud protection: Extend the FTC holder rule to apply to all schools and types of loans to ensure that schools and lenders are accountable for the financial partnerships they enter into, and that students who get ripped off have some recourse.

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[i] Project on Student Debt, *High Hopes, Big Debt*. http://projectonstudentdebt.org/files/pub/High_Hopes_Big_Debts.pdf, accessed on June 4th, 2007.

[ii] Project on Student Debt, *Quick Facts About Student Debt*. http://projectonstudentdebt.org/files/File/Debt_Facts_and_Sources_5_4_07.pdf, accessed on June 4th, 2007.

[iii] College Board, *Trends in Student Aid 2006*, http://www.collegeboard.com/prod_downloads/press/cost06/trends_aid_06.pdf

[iv] Institute for Higher Education Policy, *The Future of Private Loans: Who is Borrowing and Why?* December, 2006. http://www.ihep.org/Pubs/PDF/FutureofPrivateLoans.pdf accessed on June 4th, 2007.

[v] Kate Rube, *Private Loans: Who's Borrowing and Why?*, State PIRGs Higher Education Project, 2003.